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Abstract

Purpose – The purpose of this paper is to investigate Malaysian companies' compliance with mandatory accounting standards. Specifically, this study examines the efficacy of agency-related mechanisms on the degree of compliance with Financial Reporting Standards (FRS) 101, Presentation of Financial Statements. It so proceeds by focussing on corporate governance parameters (board characteristics and ownership structure) and other firm characteristics.

Design/methodology/approach – Using data drawn from a sample of 105 Malaysian companies listed on the ACE market in 2009, the authors employ multiple regression analysis models to establish whether selected corporate governance and company-specific characteristics (proxying for agency-related mechanisms) are related to the degree of disclosure compliance.

Findings – The results indicate that the overall disclosure compliance is high (92.5 per cent). Furthermore, only firm size is positively associated with the degree of compliance. The other variables, those consisting of board independence, audit committee independence, CEO duality, the extent of outside blockholders' ownership and leverage, do not show any significant relationship with the degree of compliance.

Research limitations/implications – This study focusses on only one accounting standard (FRS 101) that is mandatory in Malaysia. FRS 101 is both structured and rigid, leaving no room for companies to conceal any particular information. The sample of Malaysian companies selected is restricted to those listed only on the ACE market. As such, the results cannot be generalised to every company in Malaysia.

Practical implications – These results have important implications for policy makers because they suggest that whilst agency-related mechanisms may motivate compliance with mandatory standards, full compliance may be unattainable without regulations.

Originality/value – This is the only study in Malaysia to investigate the impact of regulatory requirements on corporate compliance level by companies listed on the new ACE market, which was introduced by the Bursa Malaysia in August 2009. This study contributes to the literature by examining the effects of both company-specific characteristics (such as company size, company age, liquidity, etc.) and corporate governance parameters on the degree of corporate compliance with mandatory disclosure, simultaneously, in contrast with prior studies which have examined them in isolation.

Keywords Financial reporting, Malaysia, Disclosure, Compliance, ACE market, FRS 101

Paper type Research paper

1. Introduction

The foundation of good corporate governance is transparent disclosure. If corporate sector entities do not follow the policy of complete and objective disclosure while preparing their financial statements, the users of this information do not receive early warning signals about deteriorating financial conditions. They are therefore unable to make timely adjustments. An event may suddenly unveil previously undetected risk exposure of the corporate sector and trigger panic amongst the investor community.

Deficiencies in corporate disclosure or lack of corporate transparency partly contributed to the Asian financial crisis of 1997-1998. Mitton (2002) shows that during the 1997-1998 crisis period, Asian firms with indicators of higher disclosure quality enjoyed higher returns. Mitton (2002) used a crude measure of disclosure quality and found that firms listed under American depository receipt were associated with a higher quality disclosure. This level of disclosure, he argues, is either due to mandated disclosure requirements of the

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listing exchange or to larger pool of investors spurring increased demand for disclosure and so increasing scrutiny of the firm's reports.

In order to highlight the role of disclosure deficiencies in the East Asian financial crisis, the United Nations Conference on Trade and Development commissioned a study led by Rahman in the second half of 1998. The team reviewed the published financial statements of 73 large corporations and banks in five countries – Korea, Thailand, Indonesia, Malaysia and the Philippines – for the year 1997. The actual accounting and disclosure practices of the sample companies were then used to obtain a picture of compliance with International Accounting Standards (IASs).

In the Malaysian context, Rahman (1998) found that compliance with the required accounting and reporting standards was mixed, suggesting the absence of appropriate enforcement efforts. For example, the majority of the companies concerned disclosed the amounts of inter-company receivables and payables, but there was negligible disclosure on lending and borrowing activities to their associates. On the other hand, many companies did not disclose the amounts of foreign debt, either in local currency or in the currency of repayment. In addition, the recognition and disclosure of the amount of foreign currency translation gains and losses by almost all the sample companies were not in compliance with IASs.

In a follow up study commissioned by Confederation of Asian and Pacific Accountants, Lambert and Lambert (2003) examined the extent to which the accounting weaknesses identified by Rahman (1998) have been addressed; that is, to improve their disclosure quality and thus provide a means to mitigate future financial crises. In addition to the accounting issues examined in Rahman (1998), Lambert and Lambert (2003) also included four additional disclosures contained in IASs issued since the end of 1997 and in force from December 2001. They are IAS 35 "Discontinuing Operations" and IAS 36 "Impairment of Assets", which improve the transparency of financial statements for companies potentially subject to financial distress; IAS 38 "Intangible Assets", which is likely to highlight deficiencies in capacity to support debt especially for a firm in financial distress; and IAS 39, which extends the disclosure requirements for financial assets and liabilities carried at fair values, supplementing disclosures already contained in IAS 32 "Financial Instruments: Disclosure and Presentation". The results generally indicate marked improvements in disclosure levels, observance and compliance with IASs and greater transparency. Malaysia has a relatively low level of compliance with foreign currency disclosures and derivative financial instruments. The reason here being that, unlike the IASs, the Malaysian standards remain silent on recognition, measurement or disclosure requirements in these areas.

The motivation for the study is twofold. First, we have undertaken this study to provide a more recent survey on compliance with Financial Reporting Standards (FRS) 101, Presentation of Financial Statements. Since January 2004, the Malaysian Accounting Standards Board (MASB) has required all listed companies to comply with FRS 101. However, this standard was revised in 2006 and, since then, no study has been conducted on the new ACE market introduced by the Bursa Malaysia on 3 August 2009.

The ACE market – ACE stands for access, certainty and efficiency – is different because it is sponsor-driven and open to companies of all sizes and from all economic sectors. In addition, there are no prescribed minimum operating history or profit track record requirements for entry to the ACE market. As such, this study aims to fill this gap and provide new evidence on the effect of the new market structure on disclosure behaviour by firms.

Second, we also investigate the cross-sectional variation in compliance level by focussing on corporate governance parameters (board characteristics and ownership structure) and selected firm characteristics. The year 2009 has been chosen because it was the last year before the introduction of the new FRS 101 (revised in 2009), which demanded compliance for all Malaysian public listed companies, starting from 1 January 2010. The results of the current study would indicate the extent to which the companies are ready to comply with the new requirements (starting 2010).

The results of this study will therefore provide input regarding the current accounting practices of listed companies to the relevant authorities such as MASB, Companies Commission of Malaysia (CCM), Securities Commission (SC) and Bursa Malaysia in order to evaluate the level of compliance with the MASB standards. It will also provide a reference for accounting education and research, especially in providing a comprehensive disclosure checklist regarding a specific accounting standard for preparers and practitioners.

Our paper contributes to the literature in several ways. First, we provide evidence on compliance with mandatory disclosure requirements as required by FRS 101, which is similar to IAS 1. This is in contrast to quite a substantial number of studies that merely focus on discretionary disclosures (Healy and Palepu, 2001; Graham *et al.*, 2005). The majority of the prior studies has examined the impact of different firm-specific factors on firms' compliance with IAS/International Financial Reporting Standards (IFRSs) in different jurisdictions (Çürük, 2009; Hodgdon *et al.*, 2009; Street and Gray, 2002; Wallace and Naser, 1995; Wallace *et al.*, 1994). These studies have examined the association between different firm characteristics such as firm size, leverage, profitability, audit quality, listing status and industry classification with compliance levels. None of them have included corporate governance variables as the possible determinants of compliance. The present study is, therefore, attempts to fill this gap in the literature by examining whether firms' compliance with FRS 101 is affected by firm and corporate governance characteristics such as firm size, leverage ratio, board independence, CEO duality, extent of outside blockholders' ownership and audit committee independence. Our results reveal the factors associated with disclosure compliance in one context and are a first step to determining ways to increase the rate of compliance.

Our second contribution relates to the important issue of compliance because disparate compliance impairs the ability of accounting standards to reduce information costs and information risks (Ball, 2006). Without effective enforcement even the best accounting standard might turn out to be futile (Hope, 2003). The high level of compliance by the sampled firms demonstrates the importance of strong enforcement mechanism in ensuring higher level of compliance irrespective of the market structure even in a new market place, such as the ACE market in Malaysia.

Third, our result (model 3) does support the contention that firm size positively influence compliance with mandatory disclosure requirements. This result provides justification for continued monitoring of mandatory disclosures by accounting regulators to ensure that all firms fully comply with all the accounting standards requirements.

The remainder of the paper is organised as follows. The following section, Section 2, describes the legislative and institutional structures that impact on corporate financial reporting practices in Malaysia, so developing several testable hypotheses between disclosure compliance (the extent of mandatory disclosure) and six factors (corporate governance and company-specific characteristics). Section 3 describes the procedures used to draw the sample, gather data, measure corporate mandatory disclosure compliance levels and fit the regression equation to the data. Section 4 presents and discusses the results of the statistical tests conducted. Finally, Section 5 summarises the study, highlights the limitations of the study, provides suggestions for further research and concludes the paper.

2. Literature review and hypothesis development

The quality of financial reporting of a company is influenced, to a large extent, by the financial reporting regulations of the country to which the company belongs (see Haniffa and Cooke, 2002). Financial reporting regulation is necessary to achieve quality financial reporting. There are several reasons why financial reporting regulation is necessary.

Based on the rationales provided by the economic literature Ma (1997), for instance, has cited two reasons. First, accounting information is a public good in which any interested party can have access to the information. As it is a public good, besides there being shareholders who pay for the information, free riders[1] will also obtain the information from the financial reports. Yet, in determining the quantity of information to produce, managers do not take into account the value of the information to the free riders. Thus, information is under-produced and there will be market failure[2] unless regulation of financial reporting is introduced (Watts and Zimmerman, 1986).

Second, it has been argued that management has more information about the value of a firm than do outside investors, or that there is information asymmetry. According to Watts and Zimmerman (1986), companies whose share prices are undervalued have the incentive to signal such a fact by disclosing more information. On the other hand, overvalued firms do not provide additional information; this signals the fact that the firms are overvalued. The shares of certain overvalued firms then drop and become undervalued as a result. These companies will signal this fact by providing more disclosure; hence, the process continues until the worst performing companies do not signal. However, the signalling activities can lead to the overproduction of information in financial reports. Moreover, part of the information relates to historical performance and not to future performance, entailing that no social benefit is obtained. When this happens, the authorities have to interfere and introduce financial reporting regulation to overcome market failure.

However, based on the free-market approach of the agency theory[3], it has been argued that there is no need for accounting regulations. Under the theory, accounting information is regarded as an economic good and, like any other economic good, its optimal production is determined by demand and supply factors in the market place. Since market forces can ensure an optimal disclosure, we would argue that financial reporting regulation is not necessary (Ma, 1997). Although this is a sound theory, for some reasons its practical application is believed to be limited. In the presence of regulations, however, it may be argued that this free-market approach can lead to extra disclosure in order to meet market forces, being that regulations only cover the minimum disclosure requirements.

The social environment and stage of economic development are also believed to have an influence on the financial reporting system of a country (Abdul Rahman, 1998). Hence, as the sophistication of the economy becomes greater, more regulations are likely to be needed for the country in question.

2.1 Historical development of financial reporting in Malaysia

The history of financial reporting in Malaysia is reasonably short. Although the securities industry has existed since the 1870s with the presence of British companies in the tin and rubber industries (Kuala Lumpur Stock Exchange, 1998), the first financial reporting regulation in Malaysia can be traced back only as far as 1940 when the Companies Ordinance (amendments) of 1940 was established (Tan, 2000). Further Ordinances followed in 1946 and 1956. The Ordinances played a major role in regulating financial reporting during this period, until the Malaysian Companies Act (based on the Victorian Act 1961) was enacted in 1965. Prior to the establishment of the 1965 Act, there had been calls for greater regulation in financial reporting. Babiak (1966), for instance, drew attention both to weaknesses and the absence of uniform accounting standards, areas in which improvements were needed.

The development of accounting standards only began in the late 1970s, where most of the accounting standards involved the adoption of the IAS (Tan, 2000). A major turning point in the history of financial reporting in Malaysia started in the mid-1990s when several major events took place resulting in significant impact upon financial reporting regulations. For example, the enforcement of the Financial Reporting Act 1997 took place on 6 March 1997, giving rise to the establishment of both the MASB and the Financial Reporting Foundation. The outbreak of the 1997/1998 Asian financial crisis also brought about significant development of financial reporting in Malaysia. Since then, a number of regulations have been amended and introduced.

The structure of financial reporting regulation in Malaysia is composed of legislation and requirements set by various regulatory agencies, those consisting of the government and the private agencies. The agencies involved in formulating authoritative accounting regulations and/or in enforcing these regulations include the CCM, which monitors compliance with Companies Act 1965, and the MASB, which issues accounting standards. The Companies Act, MASB standards, listing requirements of the KLSE and the guidelines of the SC are currently the major sources of reference for corporate reporting in Malaysia.

2.2 Main features of FRS 101

FRS 101, Presentation of Financial Statements (which is equivalent to IAS 1) forms the back-bone to all the other FRS. It contains the following: general rules concerning the presentation of a true and fair view; the format of the balance sheet; income statement and statement of changes in equity; and disclosure requirements, such as the name of the ultimate parent entity, that are applicable to all financial statements. The objective of FRS 101 is to ensure the comparability of financial statements. This includes both comparability of financial statements of an entity from one period to another and comparability of two or more entities within the same period of time. It prescribes the basis for preparation of general purpose financial statements.

Amongst the requirements set out in FRS 101 are:

(1) compliance with FRSs should be disclosed;

(2) all relevant FRSs must be followed if compliance with FRSs is disclosed; and

(3) use of an inappropriate accounting treatment cannot be rectified either by disclosure of accounting policies or notes/explanatory material.

However, in extremely rare circumstances FRS 101 allows that where compliance with a standard would be so misleading as to conflict with the objective of fair presentation, a company shall depart from compliance with that requirement. Departure from the FRSs is therefore required to achieve a fair presentation. The followings should be disclosed when such a departure is necessary:

(1) management confirmation that the financial statements present the entity's financial position, performance and cash flows fairly;

(2) statement that all FRSs have been complied with, except departure from one FRS, in order to achieve a fair presentation;

(3) details of the nature of the departure, why the FRS treatment would be misleading, and the treatment adopted; and

(4) financial impact of the departure.

Besides, FRS 101 also states what is required for a fair presentation:

(1) selection and application of accounting policies;

(2) presentation of information in a manner which provides relevant, reliable, comparable and understandable information; and

(3) additional disclosure where required.

It also gives guidance on how items should be presented in the financial statements. For example, FRS 101 specifies disclosures of certain items in certain ways:

(1) some items must appear on the face of the statement of financial position or income statement; and

(2) other items can instead appear in a note to the financial statements.

The adoption of FRS 101 will have a significant impact on listed companies in Malaysia and the interest shown by the local professional accounting bodies like the Malaysian Institute of Accountants and the Malaysian Institute of Certified Public Accountants, the accounting standard setter, MASB and the financial market regulator, SC. Hence, a study is timely investigating the extent of disclosures made by Malaysian listed companies under FRS 101. The study demonstrates the effectiveness of a particular regulatory policy by showing the extent of compliance with the requirements of the standard. FRS 101 disclosure has the advantage of being discretely and easily identified and also isolated in the notes of the annual report; thus the extent of disclosure can be directly measured.

2.3 Hypothesis development

Prior studies suggest that corporate compliance with mandatory disclosure is influenced by certain company-specific characteristics (e.g. Cerf, 1961; Wallace *et al.*, 1994; Owusu-Ansah, 1998, 2000; Singhvi and Desai, 1971; Belkaoui and Kahl, 1978; McNally *et al.*, 1982; Chow and Wong-Boren, 1987; Cooke, 1989, 1991; Craswell and Taylor, 1992; Meek *et al.*, 1995; Wallace and Naser, 1995; Inchausti, 1997; Dumontier and Raffournier, 1998; Street and Gray, 2001; Ali *et al.*, 2004; Akhtaruddin, 2005; Alsaeed, 2006; Al-Shammari *et al.*, 2008; Hodgdon *et al.*, 2009; Hossain and Hammami, 2009; Al-Mutawaa and Hewaidy, 2010; Al-Shammari, 2011; Juhmani, 2012; Glaum *et al.*, 2013). The characteristics considered include size, listing status, leverage, profitability, dispersion of stock ownership, industry, type of auditor and country of origin. Overall, these studies indicate that size and listing status are significantly associated with the level of disclosure. However, findings regarding the relationship between level of disclosure and other corporate variables have been mixed (see Street and Gray, 2001 for a review).

In this study, the influences of some of these characteristics have been investigated. Namely, board independence, audit committee independence, CEO duality, the extent of outside blockholders' ownership, firm size and leverage on mandatory disclosure compliance levels of Malaysian listed companies. In this section, several relational conjectures disclosure are made, those based on economic theories, prior results and a priori reasoning between each corporate-specific characteristic and mandatory compliance.

Board structure. The board of directors could effectively delineate the rights and the interests and responsibilities of the various stakeholders in the company (Ho and Wong, 2001). Nonetheless, the characteristics of the board of directors have been the focus of research, which determines its independence and so influence its effectiveness. Two important board's characteristics can be named as board independence and the separation of the board chairman and CEO (e.g. Abdullah and Mohd Nasir, 2004; Ho and Wong, 2001; Kosnik, 1987, 1990; Weisbach, 1988).

Theory on the importance of the board of directors in protecting the various stakeholders' interests is mainly derived from agency theory (Jensen, 1993; Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976). This theory predicts that the representation of outside independent directors on the board will lead to greater board incentives to fulfil their monitoring roles. This would then translate into board effectiveness, even though the evidence is mixed (Weisbach, 1988; Beasley, 1996; Abdullah and Mohd Nasir, 2004; Abdullah, 2006; Mohd Salleh *et al.*, 2004; Nosheen, 2013). Thus, outside representations do not necessarily translate into effective board monitoring.

In the Malaysian context, several studies have been carried out to examine the effects of board independence on monitoring effectiveness. The earliest work on this subject was done by Md. Nasir and Mohamed (1994), who examined the wealth effects of the announcement of outside directors. Their evidence shows that the announcement does not have any significant impact on the share price of the relevant companies. In a subsequent study by Abdullah (1999), a positive influence of board independence on earnings' quality is documented. In another study, Abdullah and Mohd Nasir (2004) focus upon the period during the financial crisis but before the implementation of the Revised Listing Requirements (RLRs). They show that board independence is not related to accrual management.

Furthermore, in examining the period after the crisis and after the implementation of RLRs, Mohd Salleh *et al.* (2004) find that board independence does not influence accrual management. Mohd Nasir and Abdullah (2004) investigate distressed companies after the crisis in the period before and during the early implementation of RLRs. Here, they do not find any significant influence of board independence on the extent of voluntary disclosure. In addition, Abdullah (2004) further extends the study on the determinants of distressed status only to find that board independence does not explain significantly the financial status of a firm. In a related study, Abdullah *et al.* (2005) do not find a significant influence of board independence on the choice of accounting for goodwill.

Existing evidence of board independence on the board's monitoring effectiveness suggests that the link is not significant. Perhaps the insignificant findings are due to two reasons. First, existing studies focus on voluntary items providing discretion to management, entailing that the board may not be interested in interfering. On the other hand, the present study focusses upon the mandatory requirements on the aspect of compliance with MASB FRS 101 standard.

Therefore, we would expect that board independence plays an important role in ensuring the management to comply with MASB approved standards in preparing the company's accounts. This is because failure to comply with the standards could lead to negative publicity and so adversely affect their value in the labour market. Furthermore, outside directors are seen by the public as "decision expert and decision ratifications" (Fama and Jensen, 1983). Being at the centre of corporate governance, board independence is expected to be associated with compliance with the MASB standards. Second, the period in which the present study is interested is the 2009 financial year, which is about eight years after the implementation of RLRs. One of the requirements of RLRs is directors' training to enable directors to enhance their capacity to discharge their duties. Therefore, we would expect that, during the period of this study, independent directors will have attended this course. Thus, we predict that this translates into compliance with the MASB standards. The above arguments lead to our first hypothesis:

H1. Board independence leads to higher level of compliance with MASB standards.

As discussed earlier, board's monitoring incentives are determined in terms of whether the roles of the board chairman and CEO are separated or combined. Combining these two roles leads to the presence of a dominant personality (Collier, 1993). Furthermore, having a non-executive chairman will promote a higher level of corporate openness (Miller, 1997). Thus, combining these roles could disrupt the flow of information to the public as argued by Ho and Wong (2001). This leads to the chairman-CEO withholding unfavourable information to outsiders. Forker (1992) also finds that CEO duality is negatively associated with the quality of share-option disclosure in the annual reports. The Financial Aspects of Corporate Governance (Committee on the Financial Aspects of Corporate Governance, 1992), the Malaysian Code on Corporate Governance (Finance Committee on Corporate Governance, 2001) and the Hampel Report (1998) each support the separation of the top roles, so ensuring that the appropriate check and balance system exists.

Daynton (1984) argues that having a board chairman who is also the firm's CEO impairs the board independence. Rechner (1989) also claims that the ideal corporate governance structure is one in which the board is composed of a majority of outside directors and a chairman who is an outside director. She states here that the weakest corporate governance is one where the board is dominated by insider directors and the CEO holds the chairmanship of the board. When one person dominates a firm, the role of independent directors (i.e. outside directors) becomes "hypothetical" (Rechner, 1989; Daynton, 1984). Rechner (1989) claims: "[…] this structure is likely to function as a rubber stamp board given the total control of the CEO" (p. 14). A structure of this kind will lead to the board being incapable of protecting the interest of the shareholders. The board, under the high influence of the management, will then be unable to discipline the management appropriately because the management who controls the board will over-rule such initiatives. On the other hand, evidence from the UK and USA is mixed (e.g. Berg and Smith, 1978; Rechner and Dalton, 1991; Chaganti *et al.*, 1985; Baliga *et al.*, 1996).

Several studies have thus far been carried out to determine the effect of the separation of the board' monitoring effectiveness and the evidence is mixed. Abdullah (1999) shows that combining the roles leads to lower earnings quality. However, in a subsequent study, Abdullah and Mohd Nasir (2004) do not find any evidence relating CEO duality to accrual management. On the other hand, Mohd Salleh *et al.* (2004) show that CEO duality leads to higher earnings management. This evidence is consistent with the evidence offered by Mohd Nasir and Abdullah (2004), who find that CEO duality is associated with a lower amount of voluntary disclosure. On the other hand, evidence from Ho and Wong (2001), using Hong Kong data, does not find a significant influence of CEO duality on the amount of voluntary disclosure. Ho and Wong (2001) argue that the insignificant association could be due to the fact that the board chairman-CEO is also the substantial shareholders. Thus, they argue that it is not important whether the two jobs are separated or combined. On the other hand, using 406 companies from the Karachi Stock Exchange for the year 2009 and 2010, Nosheen (2013) has found that CEO duality negatively affects disclosure quality of firms.

The theory of dominant personality leads us to conclude that there is a negative association between CEO duality and compliance with MASB standards. However, empirical studies, both in Malaysia and in developed countries (including Hong Kong and Singapore), show mixed evidence. Perhaps the positive effects of separating the two roles are negated by the slowness of decision-making processes which are better handled and much quicker if the two roles are combined. Although the empirical evidence is mixed, it gives rise to the hypothesis that there is a relationship between CEO duality and compliance with MASB standards:

H2. There exist a relationship between CEO duality and level of compliance with MASB standards.

Audit committee independence. Audit committees are sub-committee of the board of directors whose responsibilities are to oversee the financial reporting processes of their firms. Collier (1993) argues that audit committees help to ensure the financial accounting and control system. Forker (1992) also postulates that audit committees could effectively improve the internal control and so serve as a device for improving a firm's disclosure quality. Nevertheless, his evidence fails to support the contention. On the other hand, the evidence by McMullen (1996), Cohen *et al.* (2002) and Glaum *et al.* (2013) supports the contention of a positive and significant link between audit committee and reliable financial reporting. A study in Kuwait by Alanezi and Albolushi (2011) indicates that the existence of the audit committee is significantly and positively associated with the level of mandatory disclosure. Nonetheless, studies in Hong Kong by Ho and Wong (2001) and in Pakistan by Nosheen (2013) show no association between audit committee and the amount of voluntary disclosure.

Empirical studies on the monitoring incentives of audit committees in Malaysia have generally produced consistent results. Abdullah and Al-Murisi (1997) find that audit committee independence is not associated with its effectiveness while having a qualified accountant is associated positively with its effectiveness. In a subsequent study, Abdullah and Ku Ismail (1999) do not find any significant relationship between audit committee effectiveness (as well as having a qualified accountant) and audit committee independence. Abdullah (1999) also finds no significant influence of the audit committee independence on earnings quality. In a subsequent study, Abdullah and Mohd Nasir (2004) do not find evidence of the influence of audit committee independence on accrual management. According to the amount of voluntary disclosure, Mohd Nasir and Abdullah (2004) do not find evidence of the role of audit committee independence. Insignificant influence of audit committee independence and having qualified accountant on the audit committee is also found by Mohd Salleh *et al.* (2004).

In line with the study by Alanezi and Albolushi (2011) and due to the absence of a prior Malaysian study that has specifically examined the association between audit committee independence and the level of compliance with mandatory disclosure, the following hypothesis is developed:

H3. There is a significant positive relationship between audit committee independence and level of compliance with MASB standards.

Outside blockholders' ownership. The presence of outside blockholders is expected to have significant impact upon compliance with MASB standards because these outside blockholders could demand more information to be disclosed in the annual reports in order to ensure transparency and to reduce information asymmetry among the small shareholders. The evidence by Mohd Nasir and Abdullah (2004) supports this contention insofar as they find a positive and significant influence between outside blockholders and the amount of voluntary disclosure. Furthermore, Abdullah (2004) finds that outside blockholders are negatively associated with financial distressed status. We may therefore predict that the extent of ownership by outside blockholders leads to compliance with MASB standards because the wealth of these outside blockholders is tied to the value of the firms. Any deviations from MASB standards would lead to an auditor issuing a qualified report which could adversely affect the market valuation of the firm's shares. Thus, the extent of outside blockholders' ownership provides a greater incentive for compliance with MASB standards. These arguments give rise to our fourth hypothesis:

H4. The extent of ownership by outside blockholders leads to higher level of compliance with MASB standards.

Control variables. A large number of studies on financial disclosure have attempted to associate the extent of disclosure with the specific attributes of a company. Several company attributes have been examined in previous disclosure studies with the objective of explaining the variations in the extent of disclosure. These include variables that are associated, for example, with structure (size and capital structure), performance (profitability and growth), corporate governance and the culture of a company. The most frequently examined attributes have been corporate size and capital structure (Ahmed and Courtis, 1999).

Firm size. In numerous disclosure studies, size has persistently been found to have a positive association with the extent of annual report disclosure (Cerf, 1961; Buzby, 1975; Firth, 1979; McNally *et al.*, 1982; Naser, 1998; Daniel *et al.*, 2007; Chatham, 2008; Al-Mutawaa and Hewaidy, 2010; Santana *et al.*, 2014). Cerf (1961) provided a comprehensive discussion as to why size is hypothesised to be positively associated with the extent of disclosure. He argued that larger firms are more conscious of the needs of investors. They are likely to be in the public eye and so more subject to the pressures of shareholders and analysts.

Moreover, the accumulation and dissemination of information is costly and smaller firms might not find it worthwhile. Larger firms which are argued to have better internal reporting would have the information ready for management to be adequately informed. One would also argue that a high level of disclosure would place smaller firms in a competitively disadvantageous position.

Based on the foregoing discussion, this study hypothesises that the size of a firm is positively associated with the extent of disclosure. This study hence measures size by the total assets of a company, as a measure used in a large number of studies (e.g. Singhvi, 1968; Buzby, 1975; McNally *et al.*, 1982; Tai *et al.*, 1990; Wallace *et al.*, 1994; Hossain *et al.*, 1994; Schadewitz and Blevins, 1998). The hypothesis to be tested is:

H5. There is a positive association between the level of compliance and size of a company.

Leverage. From the perspective of agency theory, Jensen and Meckling (1976) argued that higher bonding costs would be incurred by firms that are highly leveraged. As financial disclosure is used for monitoring purposes, firms that are highly leveraged were expected to disclose more information in the quarterly reports. Thus, the relationship between leverage and the extent of disclosure is expected to be positive. Nevertheless, previous evidence shows that the results were inconclusive. Some studies have reported a positive association (e.g. Malone *et al.*, 1993; Naser, 1998; Al-Shammari *et al.*, 2008), other studies reported a negative relationship (Al-Shammari, 2011; Volkan and Ouzhan, 2014), while others found no relationship (e.g. Chow and Wong-Boren, 1987; Ahmed and Nicholls, 1994; Wallace *et al.*, 1994; Daniel *et al.*, 2007).

Based on the argument provided by agency theory, this study hypothesises that highly leveraged firms disclose more information in the annual reports compared to the lowly leveraged firms. Various measures of leverage have been adopted in the literature, depending on the objective of the analysis (Rajan and Zingales, 1995). Leverage could be measured in terms of book value (e.g. the ratio of the book value of total liabilities to book value of total assets, and the ratio of book value of debt to book value of equity) or market value (e.g. the ratio of market value of debt to market value of equity). This study measures leverage in terms of the ratio of total liabilities to total assets, as employed by Courtis (1979) and Chow and Wong-Boren (1987). Owing to the fact that some companies were insolvent and had a negative amount of equity[4], measuring leverage as debt to equity ratio might be misleading. In accordance with the foregoing discussion, the following hypothesis is to be tested:

H6. There is a positive association between the level of compliance and leverage of a company.

3. Research method

3.1 Data collection

This study focusses on Malaysian companies listed on the ACE market of the Bursa Malaysia (previously known as the Kuala Lumpur Stock Exchange) as at 31 December 2009. As of this date, there were 134 companies listed on the ACE market (Bursa Malaysia, 2010). These companies were classified into four major sectors: industrial products, trading/services, technology and finance. This study investigates factors that may influence the level of compliance by non-financial companies listed on the Bursa Malaysia for the year 2009. Therefore, the finance sector has been excluded from the study as these companies have to follow specific disclosure requirements and therefore do not have the same comparable characteristics, such as sales, as non-financial companies (Wallace and Naser, 1995).

Following the exclusion of the finance companies (22), 112 remaining companies were eligible for analysis. A letter was sent to each of these companies requesting a copy of their audited annual report for the financial year ending December 2009. In all, 105 companies responded, giving a response rate of 94 per cent. The other seven companies were new companies listed on the ACE market in January 2010 and hence their annual reports were only available for the year 2010 onwards. As such, these seven companies were excluded, thus giving a final sample of 105 companies based in the following sectors: consumer products (one), industrial products (19), trading/services (18) and technology (67) companies. The data for all the corporate governance and company-specific characteristics were obtained or computed from the annual reports of the companies in the sample.

3.2 Research instrument

This study focusses on FRS 101, Presentation of Financial Statements. This standard contains 128 paragraphs with 105 disclosure items (see Table AI for the disclosure checklist). The basis of determining whether a particular item is required for disclosure is by looking at a sentence in a paragraph that contain the words "shall disclose", "shall present", "present information", "shall be disclosed" or any other words that can be construed as something requiring to be disclosed in the annual report or financial statements.

3.3 Measuring the level of compliance

To determine the extent of compliance, this study assumes that the level of compliance is associated with the level of disclosure in the annual reports. We adopted a dichotomous procedure as adopted by Cerf (1961). Similar procedure have been used by other researchers (e.g. Naser *et al.*, 2002; Haniffa and Cooke, 2002; Ku Ismail and Abdullah, 1998; Abdul Rahman, 1998). It is a simple approach by which an item scores "1" if it is disclosed and "0" if it is not disclosed. The total disclosure (TD) score for a company is computed as follows:

$$\mathrm{TD} = \sum_{i=1}^{m} d_i$$

where $d = 1$ if the item d_i is disclosed, $d = 0$ if the item d_i is not disclosed, and $m \leqslant n$ (discussed below).

It should be noted that scoring is not a straightforward task. For instance, there were cases where companies did not mention an item of disclosure because the item was not relevant to them. If that were the case, a non-disclosure was not considered as a penalty. In contrast, if a relevant item were not disclosed, a score "0" was assigned, thus constituting a penalty. In deciding whether an item was of relevance to a company, several procedures used in prior literature were applied. First, following Cooke (1989), each annual report was read thoroughly to ascertain whether an undisclosed information item was, in fact, irrelevant to a company. Second, as in Owusu-Ansah's (1998, 2000) research, the comparative figures for each information item disclosed in one year's annual report – say 2009 – was cross-checked against the preceding (2008), and succeeding (2010) annual reports. Third, by deductive reasoning, the relevance of some information items to each company was easily established. For example, when a company had fixed assets, its depreciation policy was expected to be disclosed.

As in prior studies, the content validity of the disclosure checklist was conducted by comparing it with the guidelines issued by a Malaysian Big 4 audit firm. Thus, using this auditor's internal checklists or guidelines for statutory audit as a referent, each of the disclosure items devised for this study was revised. The disclosure checklist was applied to the financial reports of each company, and the relevant mandated information items disclosed therein were numerically scored. In addition, a Pearson product-moment correlation analysis was employed, as in prior studies, to test the reliability of the checklist after the annual reports had been scored, in order to assess the subjectivity inherent in the scoring process.

The present investigator scored the annual reports in the first instance; then another two people, independent of the study, were requested to score a randomly selected sample of ten annual reports for the same year. The reliability test was conducted on the scores obtained by these independent participants and those of the investigator. The inter-scorer coefficients were significant at the conventional levels, suggesting a minimal subjectivity in scoring each annual report for the presence of the mandated information items.

A number of earlier studies however adopted a procedure in which qualitative items were rated according to their degree of specificity (e.g. Buzby, 1974). Such an approach would produce a scale of disclosure, which varies between "0" and "1". Nevertheless, the allocation of scores was reported to be highly subjective because when user preferences were unknown, different classes of users would likely assign different weights to similar items (Cooke, 1989). Consequently, this method was not applied in this study.

Some of the earlier studies assigned weights to the disclosure items according to their importance to users of financial reports (e.g. Buzby, 1974; Wallace, 1988; Chew and Lee, 1990). However, the disclosure items used in this study were not weighted because it was assumed that each item of disclosure was equally important. This assumption is expected to be valid since this study deals only with mandatory disclosure, where all items that are required by the standards are regarded as of equally high importance. In contrast, it would have been better to have the items weighted if they had been voluntary in nature.

An index was subsequently developed to measure the relative level of disclosure by a company. The index is a ratio of the actual scores obtained by a company to the maximum score possible. Being that companies are not penalised for not disclosing irrelevant items, the maximum (M) score a company could earn varies:

$$M = \sum_{i=1}^{n} d_i \tag{1}$$

where d is the expected item of disclosure, and n the number of items which the company is expected to disclose.

The total disclosure index (TDI) for each company then becomes TD/M. The index would thus lie between 0 and 1. A score of 1 indicates that a company disclosed all the relevant items as required by the standards, while a score of 0 means that a company did not disclose any of the relevant items.

3.4 Measurement of variables and analyses

The dependent variable in this study is the extent of disclosure made by companies complying with FRS 101. As noted earlier, FRS 101 specifies the disclosure that must be made, but the extent of the disclosure is likely to vary among the companies in the sample. Hence, the study focusses on all the mandatory disclosure items, seeking to measure the extent of the disclosure. This implies that inferences were drawn from what the companies have disclosed. To examine the extent of disclosure in accordance with FRS 101 in the annual reports of the companies listed on the Malaysian ACE market, the following independent variables were tested: company size, leverage, board independence, CEO duality, audit committee independence and outside blockholders' ownership. The selection of the independent variables was based on the existing literature.

Descriptive analysis was conducted for each standard in order to determine the pattern of accounting and disclosure practices. Next, multiple regression analysis was employed to test the determinants of the comprehensiveness of the disclosures. The estimated multiple regression model takes the following form:

$$\mathrm{TDI} = \alpha + \beta 1\mathrm{BDIND} + \beta 2\mathrm{CEODL} + \beta 3\mathrm{ACIND} + \beta 4\mathrm{OUTBLK} + \beta 5\mathrm{SIZE} + \beta 6\mathrm{LEV} + \varepsilon. \tag{2}$$

TDI is the total disclosure index; BDIND the percentage of independent directors on the board; CEODL a dummy variable, "1" if the roles of the board chairman and CEO are combined, "0" otherwise; ACIND a dummy variable, "1" if all board members in the audit committee are independent directors, "0" otherwise; OUTBLK the proportion of equity ownership by substantial shareholders (with equity of two per cent or more); SIZE the natural log of book value of total assets; LEV the total debts divided by total assets; and ε the disturbance term.

4. Results and discussion

4.1 Extent of compliance: disclosure level of the sampled companies

Table I presents a distribution of the companies sampled according to the level of their compliance with the MASB disclosure requirements. The distribution was computed for every sector and for the total sampled companies. In line with the framework of analysis used by Ali *et al.* (2004) and Samaha and Stapleton (2008), a distinction was made between six levels of company compliance with MASB requirements. The categories are the following: very high compliance, if the disclosure index is 91 per cent or more; high compliance, if the disclosure index is between 80 and 90 per cent; moderate compliance between 70 and 79 per cent; intermediate compliance between 60 and 69 per cent; low compliance between 50 and 59 per cent, and below 50 per cent, which reflects a substantial gap between company disclosure practices and the MASB requirements.

Given both the results presented in Table I and the above compliance level framework, the first conclusion to note is that all the sampled companies in all the industry sectors were found to have at least 82 per cent compliance level. This result suggests that Malaysian companies listed on the ACE market of Bursa Malaysia (Malaysian Stock Exchange) complied with the majority of MASB disclosure requirements, with the lowest disclosure index of 82.5 per cent for the companies in the technology sector.

Table I also shows that about 72 per cent of the sampled companies have a disclosure level of more than 90 per cent, and 28 per cent have a disclosure level between 80 and 90 per cent. This result indicates that most of the sampled companies meet the high compliance level of the compliance framework used by Ali *et al.* (2004), and the majority of these companies are from the technology sector. Seven companies achieved the highest level of disclosure score of 100 per cent. Overall, the average compliance rate was quite high at 92.5 per cent. These results indicate that most Malaysian companies listed on the Bursa Malaysia comply with the disclosure requirements as required by the MASB standards. This reinforces the usefulness of evaluation of the factors influencing companies' compliance with MASB-required disclosures. As a finding, it is consistent with Bova and Pereira (2012), who find that public firms systematically exhibit higher compliance rates than private firms.

Disclosure level range	IP	CP	TECH	TS	Total sample No. (%)
Over 90%	12	1	50	13	76 (72%)
80-90%	4	–	21	4	29 (28%)
70-79%	–	–		–	–
60-69%	–	–	–	–	–
50-59%	–	–	–	–	–
Less than 50%	–	–	–	–	–
Total	16 (15%)	1 (1%)	71 (68%)	17 (16%)	105 (100%)
Max. disclosure level	100	91.11	100	100	100
Min. disclosure level	84.09	91.11	82.5	83.33	82.5
Overall disclosure level	92.51	91.11	92.34	93.18	92.49

Table I. Distribution of sampled companies according to their level of compliance with FRS 101

4.2 Univariate analysis

Table II (Panels A and B) reports descriptive statistics for all the variables in Equation (2). Panel A shows that some variables are highly skewed and were hence transformed as follows: SIZE (total assets) using natural logarithm and leverage using cosine. According to Snee (1973), standardising variables also offer the following benefits: it converts data to a common scale, it improves the precision of regression estimates, and it reduces collinearity problems among independent variables. The proportion of independent directors on the board ranges from 25 to 100 per cent, with a mean of 46 per cent. The extent of ownership by outside blockholders ranges from 0 to 88 per cent, with a mean of 29 per cent. Table II (panel B) shows that nearly 56 per cent of companies do not separate the roles of CEO and board chair. In contrast, only 47 per cent of companies have all their board members in the audit committee as independent directors. With regard to the control variables, Table II shows that the extent of leverage ranges from 0 to 3.85 per cent, with a mean of 0.37 per cent. The total asset has a mean value of RM54 million, with a maximum value of RM735 million and minimum value of RM196,000.

4.3 Bivariate analysis

Table III presents the Pearson and Spearman product-moment pairwise correlation coefficients between the independent variables. However, the results in Table III provide no indication that an unacceptable level of multicollinearity is present in the data. Gujarati (1995, p. 335) suggests that harmful levels of multicollinearity are present when bivariate correlations reach 0.80. In this study, no correlation coefficient between the independent variables reached this level – the highest being only 0.41.

Panel A: continuous variables (n = 105 firms)

Variable	Mean	Median	Minimum	Maximum	SD	Skewness
Outblk	29.25	25.00	0.00	88.21	21.78	0.381
Bdind	0.46	0.43	0.25	1.00	0.14	0.874
Ceodl	0.44	0.00	0.0	1.0	0.50	0.253
Acind	0.47	0.00	0.0	1.0	0.50	0.136
TDI	92.50	92.68	82.50	100.00	4.44	−7.396
Size (in '000,000 RM)	53.90	39.30	0.19	734.90	865.06	6.174
LnSize	17.27	17.46	12.19	20.42	1.12	6.510
Lev	0.37	0.32	0.00	3.85	0.42	5.630

Panel B: dichotomous (dummy) variables (n = 105 firms)

Variable	*N* = 0	*N* = 1
CEODL	59 (56.2%)	46 (43.8%)
ACIND	56 (53.3%)	49 (46.7%)

Table II.
Descriptive statistics

	Outblk	Lev	Bdind	Ceodl	Acind	TDI	Size
Outblk	1	−0.083	0.044	−0.061	−0.035	0.062	0.061
Lev	−0.094	1	−0.002	0.235**	−0.052	0.114	0.141
Bdind	0.049	−0.061	1	0.067	0.435**	0.083	0.028
Ceodl	−0.043	0.215*	0.036	1	0.213*	0.079	−0.088
Acind	−0.058	0.032	0.409**	0.213*	1	−0.055	−0.081
TDI	0.056	0.014	0.023	0.073	−0.066	1	0.209*
Size	0.028	−0.246**	0.062	−0.091	−0.089	0.153	1

Note: *,**Correlation significant at 0.05 and 0.01 levels (one-tailed), respectively

Table III.
Pearson (Spearman) correlation below (above) diagonal for variables in regressions

4.4 Multivariate analysis

In order to conduct regression analysis, several assumptions must be satisfied, these are: linearity of relationships, absence of multicollinearity, the values of the dependent variable are normally distributed for the values of each of the independent variables, and the residuals have constant variance throughout the domain of the independent variables (homoscedasticity). Tests of multicollinearity are conducted using the Pearson correlation matrix (already discussed in the prior section) and the variance inflation factor (VIF). Although there is no clear cut rule for which value of the VIF should be cause for concern, it has been suggested that collinearity is considered a problem when the VIF value exceeds 10 (Neter *et al.*, 1989; Mendenhall and Sincich, 1989). None of the independent variables (results not presented) have a value exceeding 10. The highest VIF calculated was 1.283 for ACIND, suggesting that there is no serious problem in interpreting the regression results. To test for the assumption of a normally distributed residual error, histograms of the studentised residuals and normal plots are used. Homoscedasticity is tested using the studentised residuals plots against the predicted values of the dependent variable and the Breusch-Pagan/Cook-Weisberg test.

The results of our regression analyses are shown in Tables IV and V. Table IV reports the results for models 1 and 2, with the disclosure score as the dependent variable. As firm size can proxy for many other variables, so we conducted two multiple regressions. Model 1 includes all variables while model 2 excludes the size variable. Both models are not significant, with an adjusted R^2 of −0.016 ($p < 0.624$) for model 1 and −0.028 ($p < 0.825$) for model 2.

The board independence (BDIND) variable has a positive relationship with TDI but is not significant. The result does not support *H1*. A possible reason for our non-significant result with respect to board independence is the lack of variation in practice among the companies in our sample. As evidenced by our descriptive statistics, most companies now comply with recommended corporate governance practice in striving to have more independent boards. This finding supports prior studies by Abdullah (1999), and Abdullah and Mohd Nasir (2004), Kent and Stewart (2008) and Al-Akra *et al.* (2010), but does not support the significant and positive results found by Chen and Jaggi (2000) and Cheng and Courtenay (2006).

The hypothesis (*H2*) that there is a relationship between CEO duality (CEODL) and level of compliance with MASB standards is not supported, but is positively related to TDI. This finding is inconsistent with the evidence offered by Mohd Nasir and Abdullah (2004),

Variable	Predicted signs	Model 1 Coefficients	*t*-values	Sig.	Model 2 Coefficients	*t*-values	Sig.
(Constant)		0.811	11.656	0.000	0.908	35.542	0.000
Outblk	+	0.070	0.706	0.482	0.068	0.676	0.501
Bdind	+	0.042	0.386	0.700	0.056	0.510	0.611
Ceodl	−(+)	0.103	0.997	0.321	0.101	0.970	0.335
Acind	+	−0.089	−0.796	0.428	−0.107	−0.956	0.341
Size	+	0.155	1.485	0.141			
Lev	+	−0.015	−0.145	0.885	0.028	0.276	0.783
R^2			0.043			0.021	
Adj. R^2			−0.016			−0.028	
F			0.733	0.624		0.433	0.825
n			105			105	

Notes: Outblk is the cumulative percentage of shares owned by outside blockholders with shareholdings 2 per cent and above; Bdind is the percentage of independent directors on the board; Ceodl is a dummy variable, 1 if the roles of the board chairman and CEO are combined, and 0 otherwise; Acind is a dummy variable, 1 if all members are independent directors, and 0 otherwise; Size is natural log of book value of total assets; Lev is total debts divided by total assets

Table IV. Regression results – all firms

Variable	Predicted signs	Model 3 Coefficients	*t*-values	Sig.	Model 4 Coefficients	*t*-values	Sig.
(Constant)		65.128	5.075	0.000	89.285	46.397	0.000
Outblk	+	0.127	1.249	0.215	0.120	1.161	0.249
Bdind	+	0.140	1.284	0.203	0.135	1.215	0.228
Ceodl	−(+)	0.090	0.857	0.394	0.076	0.713	0.478
Acind	+	−0.110	−0.982	0.329	−0.120	−1.048	0.298
Size	+	0.215	2.050	0.043			
Lev	+	−0.034	−0.320	0.750	−0.089	−0.863	0.390
R^2			0.095			0.052	
Adj. R^2			0.034			0.000	
F			1.560	0.168		0.996	0.425
n			105			105	

Table V.
Regression results – firms with outliers removed

who find that CEO duality is associated with lower amount of voluntary disclosure; Mohd Salleh *et al.* (2004) who find that CEO duality leads to higher earnings management; Chau and Gray (2010) and Daniel *et al.* (2007) who find that an independent CEO is associated with higher amount of voluntary disclosure; as well as by Nosheen (2013), who find that CEO duality negatively affects disclosure quality. However, the hypothesis supports the findings of Ho and Wong (2001) who find no significant influence of CEO duality on the amount of voluntary disclosure. It also supports the findings of Kent and Stewart (2008) and Wan Mohamad and Sulong (2010) who find no significant influence of CEO duality on the amount of mandatory disclosure.

The hypothesis (*H3*) that audit committee independence (ACIND) is positively associated with compliance with MASB standards is not supported by the data. In addition, the result shows a negative relationship. This finding supports prior studies by Abdullah and Ku Ismail (1999), Abdullah (1999), Abdullah and Mohd Nasir (2004), Kent and Stewart (2008) and Nosheen (2013). The explanation for the lack of highly significant relationship between the independence of a corporate audit committee and the extent of compliance may be that noted by Kalbers and Fogarty (1993, p. 27), insofar as establishing an audit committee is one thing, while establishing an effective audit committee is quite another. Indeed, prior research has shown that key audit committee characteristics (such as independence from management, expertise of members in the areas of accounting and financial reporting, and frequency of meeting), rather than the mere existence of an audit committee, critically impacts upon the audit committee's ability to execute its objectives and responsibilities effectively (Abbott and Parker, 2000, 2001; Beasley *et al.*, 2000; Raghunandan *et al.*, 2001; Carcello and Neal, 2003).

The firm size (S1ZE) variable shows a positive sign relationship with TDI as expected, but it is not significant. The SIZE variable was expected to have a positive sign, given the economies of scale in the production and dissemination of information, so postulating a direct relationship between company size and the extent of compliance. The lack of statistical significance of the SIZE variable is due to the high compliance of Malaysian companies with MASB disclosure requirements, irrespective of whether they are small or big companies in terms of total assets. Being that the sample of this study consists solely of publicly held companies, the size effect will hence be more difficult to detect by any statistical test.

In addition, the hypothesis that the extent of ownership by outside blockholders (OUTBLK) leads to higher level of compliance with MASB standards is not supported by the data. This evidence is consistent with that of Broberg *et al.* (2010) and Alanezi *et al.* (2012) who find no association between dispersed ownership and voluntary disclosure, but inconsistent with that of Mohd Nasir and Abdullah (2004) who find a positive and significant influence between outside blockholders and the amount of voluntary disclosure.

The other variable that shows no significant negative (or positive) relationship (in both models 1 and 2) with TDI is leverage (LEV). This finding supports the findings in prior studies by Courtis (1979), Chau and Gray (2010), Hossain and Adams (1995), Agyei-Mensah (2012) and Santana *et al.* (2014) in annual report studies, and Schadewitz and Blevins (1998) in interim report studies.

We have also conducted additional analyses by removing nine companies having outliers from the "size" variable. Table V reports the results for models 3 and 4. Model 3 includes all variables while model 4 excludes the size variable. Both models are not significant, with adjusted R^2 of 0.034 ($p < 0.168$) for model 3 and 0 ($p < 0.425$) for model 4.

Table V shows that firm size (S1ZE) has a positive significant relationship with TDI as expected (at the 5 per cent level). This finding support the findings in prior studies by Courtis (1979), Hossain and Adams (1995), Daniel *et al.* (2007), Chau and Gray (2010), Broberg *et al.* (2010), Al-Shammari *et al.* (2008), Al-Shammari (2011), Nosheen (2013), and Santana *et al.* (2014). However, no significant associations exist between disclosure score and all other independent variables in models 3 and 4.

In summary, the empirical analysis suggests that size alone is the most critical explanatory factor of the extent to which Malaysia-listed companies complied with MASB accounting standards. The other variables do not show any significant relationship with degree of compliance; that is, those consisting of board independence, audit committee independence, CEO duality, the extent of outside blockholders' ownership and leverage.

5. Summary, conclusion and recommendation

The purpose of this study has been to investigate empirically the relationships between six factors (corporate governance and company-specific characteristics) and the extent of compliance with MASB accounting standards by companies listed on the ACE market of Bursa Malaysia (Malaysian Stock Exchange) for the financial year ending 2009. The empirical results indicate that firm size is the only factor that can explain the degree of corporate compliance with mandatory disclosure requirements in Malaysia. All the other five variables show insignificant relationship. The results of this study provide several important inferences. First, the empirical evidence suggests that, irrespective of their different characteristics, Malaysian companies tend to ensure a high compliance with the disclosure requirements imposed by the relevant regulatory bodies. Even though the nature of stocks in ACE market is deemed to be too speculative and high risk (Sulong *et al.*, 2013) and the companies listed on the ACE market are mostly technology firms (68 per cent), they still provide a high degree of compliance.

The interpretation we have given here is that accounting standards may not translate into higher disclosure quality if countries are unable to enforce the standards effectively (Bova and Pereira, 2012). Daske *et al.* (2008) echo similar findings. They focus on mandatory IFRS adoption around the world and find that it leads to improvements in liquidity. However, similar to Armstrong *et al.* (2010), they find that the effects are not uniform across countries, with limited positive effects in low enforcement countries. In the Malaysian context, the MASB has been continuously adopting accounting standards issued by the IASB. As for ACE listed companies, they have to follow the regulations imposed by the SC, who requires them to follow the accounting standards issued by MASB. As such, they have no choice other than to follow the provisions contained in the specific accounting standards such as the FRS 101.

The FRS 101 itself provides a specific line by line item that need to be disclosed by firms. Firms have to disclose the items in their financial statements; in no way can they evade such disclosures unless one of the items is totally irrelevant to their business operation. Hence, the results of this study have served to provide a message to accounting regulators around the world that an accounting standard which provides a clear and specific line by line items would help companies to disclose the items in their financial statements. In addition, a higher enforcement mechanism would ensure a higher compliance level by firms.

Overall, the results provide strong evidence that larger companies tend to provide greater compliance with MASB accounting standards compared to smaller companies. Therefore, policy makers in Malaysia may focus more on small companies in an educational effort to prepare these companies across the country for their external reporting responsibilities once the IFRSs are fully adopted in the country.

The results of this study are subject to several limitations. First, while extensive efforts have been made to develop an accurate proxy for the extent of compliance with accounting standards, the assumption that each disclosure item may represent the degree of compliance, as evidenced by the dichotomous scoring of the items, is to be regarded as subject to some degree of subjectivity. The disclosure of the same items by companies, but located in different sections of their annual reports, makes the comparison much more difficult. In addition, the number of non-applicable items also varies between different companies in different industries, which in turn affect the scoring of disclosure items. Second, the results may not be generalisable to all companies listed on the Malaysian Stock Exchange (Bursa Malaysia), as the empirical analysis is limited only to those Malaysian companies listed on the ACE market. Third, given the exceedingly complex nature of corporate disclosure, there are inherent limits in the ability of empirical research to capture all the factors that influence disclosure decisions made by the management of companies. Finally, the regression analysis does not resolve issues of causality. The observed relationships between the company-specific characteristics and the extent of compliance do not necessarily prove causation.

Kerlinger (1973. p. 393) cautioned, "[…] the study of cause and causation is an endless maze. One of the difficulties is that the word 'cause' has surplus meaning and metaphysical overtones. Perhaps more important, it is not really needed." Consequently, the coefficients of any significant company-specific characteristics in the regression equation should not be viewed as elasticities that predict how much the extent of compliance will change following a change in any of these characteristics. Rather, the estimated coefficients evaluate the strength of the partial correlation between the characteristics and the degree of compliance. Although the observed relationships reported in this study do not establish causality, Graziano and Raulin (1997) argue that they serve two functions. First, any consistent relationships found in the data can be used to predict future events, which is one of the stated motivations for this study. Second, it provides data that is either consistent or inconsistent with some currently held scientific theory.

Several new directions for future research are suggested by the research design of this study. First, the relatively low adjusted R^2 suggest, in some cases, that there are several missing variables not factored into the estimation. Thus, in addition to those characteristics investigated in this study, the relationships between multiple-listing status, the internationalisation of operations and affiliation with multinational corporations, as well as other important financial ratios and company age, should be investigated in future studies. Second, this study could be replicated using cross-national data. For example, data from Malaysia could be compared with that of other ASEAN or Asian countries, as these countries have similar accounting infrastructure and have also experienced changes in the financial reporting regulatory regimes. Finally, a longitudinal approach may be used to investigate the degree of compliance over a long period or for a certain period before and after the effective implementation year, in order to examine the trend or behaviour of disclosure, as well as specific types of corporate disclosure in Malaysia, such as segmental reporting.

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Notes

1. A free rider is a person who does not purchase the public good, being that he is assured of the supply once it is made available to the public.
2. According to Watts and Zimmerman (1986), market failure either exists when accounting information produced in the absence of regulation is non-optimal in a Pareto sense, or because the market for financial information results in resource allocation which is inequitable; that is, "unfair" to some groups or individuals.
3. Agency theory assumes a relationship between the principal (owner) and agent (manager) in which the agent manages the wealth of the principal. In such a relationship, information from the agent is desired by the principal in order to monitor the agent's behaviour, as well as to motivate the agent to act in the principal's interest.
4. In Malaysia, a KLSE listed company whose equity is negative is classified as a Practice Note 4 (PN4) company.

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Further reading

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(The Appendix follows overleaf.)

Appendix. Disclosure checklist

Item No.	Para.	Type and major items of disclosure
1	16	An explicit and unreserved statement of compliance with MASB standards in the notes
2	20-a	Any departure from MASB standards (no prohibition) require: disclosure that the financial statements present fairly the enterprise financial position, financial performance and cash flows
3	20-b	Statement that departure from MASB standards in order to achieve a fair presentation
4	20-c	standards that the enterprise has departed, the nature of departure, treatment of departure, reason why treatment would be misleading and the treatment adopted
5	20-d	The financial effect of such departure on financial statements
6	21	MASB standards departed in prior period and affect the current period
7	23a	that the enterprise has departed, BUT the regulatory framework prohibit it; then disclose title, nature and reason of departure
8	23b	Adjustment to each item for each period
9	25	Uncertainties affecting firm's going concern basis
10	25	Fact, basis and reasons for financial statements not prepared on a going concern basis
11	36-a	Reason for using a longer or shorter period financial year
12	36-b	The fact that amounts presented in the financial statements are not entirely comparable
13	38	comparative information in respect of the previous period for all amounts reported in the current period's financial statements
14	41	When comparative amounts are reclassified, disclose: (a) the nature of reclassification
15		(b) Amount of each item reclassified
16		(c) The reason for reclassification
17	42	When impracticable to reclassify, disclose: (a) the reason for not reclassifying,
18		(b) Nature of adjustment that would have been made if the amounts had been reclassified
19	51	Clearly identify each financial statement and the notes
20	51a	The name of the reporting entity
21	51b	The financial statements are of an individual entity or a group of entities
22	51c	Date of the end of the reporting period or the period covered by the set of financial statements or notes
23	51d	Presentation currency
24	51e	Level of rounding used in presenting amounts
25	54	Statement of financial position (Balance sheet) should include: (a) property, plant and equipment
26		(b) Investment property
27		(c) Intangible assets
28		(d) Financial assets (excluding amounts shown under (e), (h) and (i))
29		(e) Investment accounted for using the equity method
30		(f) Biological assets
31		(g) Inventories
32		(h) Trade and other receivables
33		(i) Cash and cash equivalents
34		(j) Total assets classified as held for sale
35		(k) Trade and other payables
36		(l) Provisions
37		(m) Financial liabilities (excluding amounts shown under (k) and (l))
38		(n) Liabilities and assets for current tax, as defined in FRS 112
39		(o) Deferred tax liabilities and deferred tax assets, as defined in FRS 112
40		(p) Liabilities included in disposal groups classified as held for sale in accordance with FRS 5

(*continued*)

Table AI. Financial reporting standard 101-presentation of financial statements

Item No.	Para.	Type and major items of disclosure
41		(q) Non-controlling interests/minority interest, presented within equity; and
42		(r) Issued capital and reserves attributable to equity holders of the parent
43	60	Present all assets and liabilities in order of liquidity
44	61	For each asset or liability items, amounts expected to be recovered or settled: (a) no more than 12 months after the reporting period
45		(b) More than 12 months after the reporting period
46	66	Disclose current assets
47	66	Disclose non-current assets
48	69	Disclose current liabilities
49	69	Disclose non-current liabilities
50	77	Further sub-classification of the line items presented, classified in manner appropriate to the entity's operation
51	79-a	For each class of share capital: (i) the number of shares authorised
52		(ii) The number of shares issued and fully paid, and issued but not fully paid
53		(iii) Par value per share, or that the shares have no par value
54		(iv) A reconciliation of the number of shares outstanding at the beginning and at the end of the year
55		(v) The rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital
56		(vi) Shares in the entity held by the entity itself or by subsidiaries or associates
57		(vii) Shares reserved for issuance under options and sales contracts, including the terms and amounts
58	79-b	A description of the nature and purpose of each reserve within equity
59	80A-a	Puttable financial instrument – amount reclassified, the timing and reason for the reclassification
60	80A-b	An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation – amount reclassified, the timing and reason for the reclassification
61	81	Statement of comprehensive income: present all items of income and expense recognised in a period: (a) in a single statement of comprehensive income, or
62		(b) In two statements
63	82	Information to be presented in Statement of comprehensive income: (a) revenue
64		(b) Finance costs
65		(c) Share of profits and losses of associates and joint ventures accounted for using the equity method
66		(d) Tax expense
67		(e) A single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation
68		(f) Profit or loss
69		(g) Each component of other comprehensive income classified by nature (excluding amounts in (h))
70		(h) Share of the other comprehensive income of associates and joint ventures accounted for using the equity method
71		(i) Total comprehensive income
72	83-a	The following items shall be disclosed in the statement of comprehensive income as allocations for the period: (i) profit or loss attributable to non-controlling interests
73		(ii) Profit or loss attributable to owners of the parent
74	83-b	(i) Total comprehensive income for the period attributable to non-controlling interests
75		(ii) Total comprehensive income for the period attributable to owners of the parent

(*continued*)

Table AI.

Item No.	Para.	Type and major items of disclosure
76	90	Disclose the amount of income tax relating to each component of other comprehensive income, including reclassification adjustments, either in the statement of comprehensive income or in the notes
77	92	Disclose reclassification adjustments relating to components of other comprehensive income
78	97	When items of income or expense are material, an entity shall disclose their nature and amount separately (e.g. disposals of items of property, plant and equipment, refer para 98)
79	104	Entities classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense
80	106	Statement of changes in equity: (a) total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests
81		(b) For each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with FRS 108
82		(d) For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from: (i) profit or loss
83		(ii) Each item of other comprehensive income
84		(iii) Transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control
85	107	The amount of dividends recognised as distributions to owners during the period, and the related amount per share
86	112	The notes: (a) present information about the basis of preparation of the financial statements and the specific accounting policies
87		(b) Disclose the information required by FRSs that is not presented in the financial statements; and
88		(c) Provide additional information that is not presented in the financial statements, but is relevant to an understanding of any of them
89	113	Each item in statements of financial position, comprehensive income, separate income statement, statements of changes in equity and of cash flows is crossed-referenced to the related notes
90	108	Disclosure of accounting policies: (a) the measurement basis (or bases) used in preparing the financial statements;
91		(b) Other accounting policies used that are relevant to an understanding of the financial statements
92	122	The judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have most significant effect on the amounts recognised in the financial statements
93	125	Key assumptions concerning the future, other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities: (a) in respect those assets and liabilities, details of their nature
94		(b) Their carrying amount as at the balance sheet date
95	134	An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital
96	136A	For puttable financial instruments classified as equity instruments, an entity shall disclose: (a) summary quantitative data about the amount classified as equity
97		(b) Its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period
98		(c) The expected cash outflow on redemption or repurchase of that class of financial instruments

Table AI. (*continued*)

Item No.	Para.	Type and major items of disclosure
99		(d) Information about how the expected cash outflow on redemption or repurchase was determined
100	137	An entity shall disclose in the notes:
		(a) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners during the period, and the related amount per share
101		(b) The amount of any cumulative preference dividends not recognised
102	138	Other disclosures:
		(a) the domicile and legal form of the entity, its country of incorporation and the address of the registered office (or principal place of business, if different from the registered office)
103		(b) A description of the nature of the enterprise's operations and its principal activities; and
104		(c) The name of the parent and the ultimate parent of the group
105		(d) If it is a limited life entity, information regarding the length of its life

Table AI.

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